Indian Economy · GS - III

Examine how changes in capital gains taxation can influence foreign portfolio investment in India. Discuss the broader factors required to sustain foreign investment inflows.

EXAM YEAR	PAPER	SUBJECT
DAILY PRACTICE 29/10/2026	GS - III	Indian Economy

MARKS	WORD LIMIT
10	~150 words

Answer Hint

LTCG taxation; post-tax investment returns; foreign portfolio investment; capital market volatility; rupee stability; corporate earnings; global interest rates; policy predictability; financial market reforms

Model Answer

Introduction

Foreign portfolio investment (FPI) contributes to capital-market liquidity, price discovery and access to international savings. Changes in long-term capital gains (LTCG) taxation can influence investor decisions by altering post-tax returns.

Potential Impact of an LTCG Tax Reduction

Investor Sentiment: Lower capital gains taxation may improve the attractiveness of Indian equities relative to competing markets, encouraging investors to reconsider their allocations.

Market Liquidity: Renewed foreign inflows can support trading activity and valuations, particularly in heavily sold financial stocks and large-cap companies.

Currency Effects: Stronger portfolio inflows may support demand for the rupee, although exchange rates also depend on trade balances, oil prices and global monetary conditions.

Limitations and Risks

Tax reductions alone cannot guarantee sustained inflows. Foreign investors also assess corporate earnings, market valuations, governance standards, regulatory predictability and global risk appetite. Sudden capital outflows can increase market volatility and currency pressures.

Way Forward

India should maintain a predictable tax regime, strengthen investor protection, deepen bond markets, improve corporate governance and sustain macroeconomic stability. Policy decisions should balance investment competitiveness with revenue requirements and tax equity.

Conclusion

Competitive capital gains taxation can support investor confidence, but durable FPI inflows depend on strong economic fundamentals, credible institutions and consistent policies rather than tax concessions alone

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